

CPI INFLATION UNDER RECENTLY RELEASED CES SURVEY AT 4.7%, AGAINST 5.1%: DEPARTMENT OF CONSUMER AFFAIRS MAY PUBLISH A COMPREHENSIVE LIST OF VEGETABLE PRICES EVERY MONTH APART FROM ONLY TOMATO, ONION AND POTATO (TOP)

**Issue No. 41, FY24
Date: 12 Mar 2024**

India's retail inflation has eased marginally to 4-months low of 5.09% (SBI Estimate: 5.09%) in February 2024, compared to 5.10% in January, due to the deceleration in all categories except food.

The persistence in food inflation carried in current month. Food inflation increased to 7.76% from the previous month print of 7.58%. Within food inflation, protein items (meat, egg) inflation increased exorbitantly (in the range of 400-500 bps) in February month as compared to Jan month. Vegetable prices also increased m-o-m by 300 bps to 30.2%. Core CPI declined to 3.37% - a 52-months low and reached the level of Oct-19. The present reading a trend reversal in CPI after its acceleration due to covid-19 and subsequently declined.

With moderate fuel prices, inflation is currently being driven by food price dynamics. Looking ahead evolving food prices will determine domestic inflation. **CPI inflation is expected to remain slightly above 5.0% till May and declining thereafter to 3% in July. Inflation is expected to stay below 5% beginning November till the end of FY25.** Spatial heatmap shows that the largest weighted contribution to the current reading of CPI came from Maharashtra and Uttar Pradesh.

Despite the expected trajectory in CPI, the abrupt large fluctuation in many of the CPI sub-components underscores the need to revisit the base year and estimation methodology of CPI. Recent release of CES (2022-23) may have an impact on food CPI and subsequently on overall CPI as the weights of major food items has been revised from 47.8% in 2011-12 to 42.8% in 2022-23 at all India level. There is urgent need to rationalise the weights under CPI. **However what is important is the significant divergence between NAS data and CES data. The NAS data typically captures the PFCE data and this data as released by NSO on February 29 shows a significant divergence of amount spent on food.**

Since CPI is basis for RBI's monetary policy decisions it should be appropriately calculated. By substituting existing weights with new weights, the new headline CPI is lower than the old headline CPI in the recent period by around 40 bps.

Parallely in February, the US Consumer Price Index for All Urban Consumers increased 0.4 percent, seasonally adjusted, and rose 3.2 percent over the last 12 months, not seasonally adjusted. The index for all items less food and energy increased 0.4 percent in February (SA); up 3.8 percent over the year (NSA). Thus Federal reserve is expected to keep a pause till CPI show convincing decline.

Taking all factors into account, our ANN model incorporating data up to Aug 23 with lag 1 data of CPI, Core CPI and Fed rate shows that RBI may keep the repo rate unchanged at 6.5%, as such the first-rate cut is scheduled in Q2FY25.

From the supply side, IIP grew by 3.8% in Jan'2024 compared to 4.2% (revised) in Dec'23 and 5.8% in Jan'23. Mining grew by 5.9%, Manufacturing grew by 3.2% and Electricity grew by 5.6%. Meanwhile, for April-January 2024, industrial growth stood at 5.9% as against 5.5% in April-January 2023.

Based on our inhouse ANN model the current repo rate at 6.5%, looks ideal. We can expect the first rate cut only in Q2FY25.

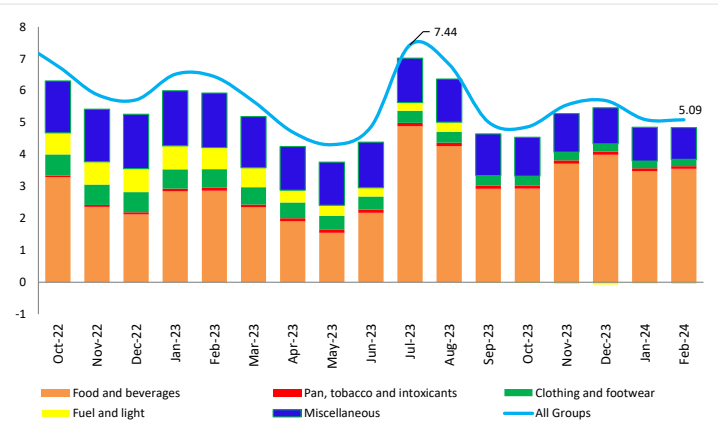
CPI INFLATION EASED MARGINALLY TO 5.09%

- ◆ India's retail inflation has eased marginally to 4-months low of 5.09% (SBI Estimate: 5.09%) in February 2024, compared to 5.10% in January, due to the deceleration in all categories except food. Food inflation, however increased to 7.76% from the previous month print of 7.58%. Within food inflation, protein items (meat, egg) inflation increased exorbitantly (in the range of 400-500 bps) in February month as compared to Jan month. Vegetable prices also increased m-o-m by 300 bps to 30.2%
- ◆ Interestingly, core CPI declined to 3.37% which is 52-months low and reached the level of Oct-19. This is like home-coming for core, which has increased due the arrival of covid-19 and then subsequently declined.

GAP BETWEEN NSS AND NAS NEEDS TO BE ADDRESSED

- ◆ Recent release of CES (2022-23) may have an impact on food CPI and subsequently on overall CPI as the weights of major food items has revised from 47.8% in 2011-12 to 42.8% in 2022-23 at all India level. However what is important is the significant divergence between NAS data and CES data. The NAS data typically captures the PFCE data and this data as released by NSO on February 29 shows a significant divergence of amount spent on food.
- ◆ The NAS and CES estimates have difference in coverage, estimation methods and databases, and, therefore, the two should be different. For e.g., with respect to coverage, consistency with accounting conventions requires that the PFCE by NAS be subject to a wider coverage than the one drawn from the NSS.
- ◆ NSS is a directly observed stand-alone estimate relating to a given survey period (usually a year, as noted above) – while PFCE from NAS is an indirect, residual macro-level estimate of aggregate PFCE derived from GDP estimate. The residual nature of PFCE arises from its use of the commodity-flow method at the disaggregated level of a commodity or service. This method employs an ex post aggregate commodity-flow balance in which economy wide domestic production is equated to its various uses.
- ◆ **Against such backdrop, we believe that there is urgent need to rationalise the weights under CPI and also the gap with NSO PFCE data. Since CPI is basis for RBI's monetary policy decisions it should be appropriately calculated. By substituting existing weights with new weights, the new headline CPI is lower than the old headline CPI in the recent period by around 40 bps.**

Weighted Contribution of Retail Inflation (%)



Source: SBI Research

Difference between NSS and NAS: Some Examples

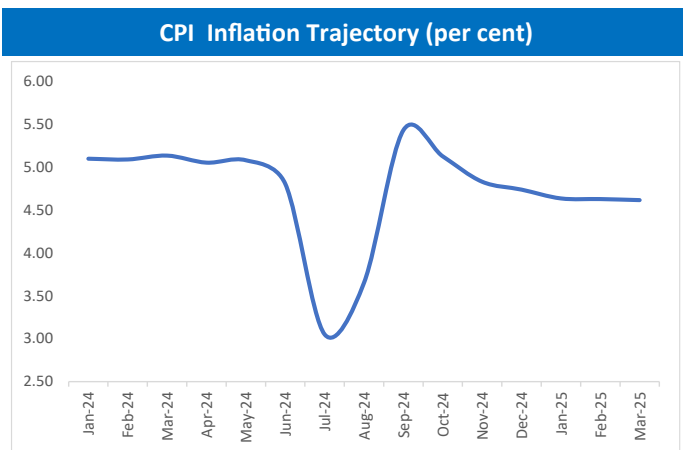
Fruits & Vegetables	It is generally contended that the NSS is not able to capture all expenditure on fruits, and that their estimates of fruit consumption are on the low side: nevertheless, there are certain major classification differences between the two sources which would affect the comparability of the two sets of estimates. For instance, a large portion of the mango crop is used as amchur (dried mango slices) which is reported under spices in the NSS classification. The NSO, on the other hand, shows the entire mango crop under the fruits and vegetables group. This might also be true for many other items such as dry chillies, ginger, etc.
Cereals and cereal products	Both the NAS and NSS value estimates for the items in the rice and wheat groups represent the expenditure actually incurred on the items. The quantity available from the Public Distribution System (PDS) is evaluated at the administered price in the NAS, while the cost actually paid by the households for the quantity obtained from the PDS are recorded in the HCES.
Milk and Milk Products	A large quantity of milk and milk products is used by the commercial establishments for making sweets, tea, coffee, etc., which is included in the NSO estimates of private consumption of milk but is excluded from the NSS estimates.
Edible oil and Oilseeds	For the NAS estimates, the NSO uses the estimates of oilseeds production available from the Directorate of Economics and Statistics, Ministry of Agriculture (DESAg) and those of edible oils production from Ministry of Food and Civil Supplies. These estimates of edible oils are in fact derived on the basis of certain assumptions on utilisation of oilseeds for different purposes like seed, feed, waste etc. and oil extraction rates, but for vanaspati no adjustment is made for its use in other industries. This appears to be an important reason for the difference between the estimates of vanaspati consumption, since it is used extensively in commercial establishments like halwais, hotels and restaurants.

HOW CHANGING SPENDING BEHAVIOR IMPACTS CORE CPI INFLATION

- ◆ At all-India level, while CPI inflation declined by 270 bps to 5.09% in Feb'24 as compared to Apr'22 level, during the same period the weighted contribution of core CPI declined by 176 bps.
- ◆ Of this decline, the three segments (transportation & communication, clothing and footwear and household goods) contributed 76% of total decline in core inflation: (a) In Rural these segments contribute 75.5% decline in core CPI, (b) In Urban these segments contribute 79.8% decline in core CPI.
- ◆ When we analyze the item-wise decline in weighted contribution of core CPI, the results are surprising.
- ◆ **Notably, since the decline in core is visible in both rural and urban areas and in goods and services that are quintessential to the day-to-day living, to confer that core decline is a proxy for decline in demand or rural slowdown is misleading.**
- ◆ For example, the 43-bps decline in weighted contribution in clothing and footwear/household goods & services is due to decline in items like saree, shirt, trouser, clothing material, washing soap, bedsheet, etc. that are part of daily living.
- ◆ The only reason for this phenomena is the changing behaviour of customers in buying things. We believe that peoples are actively using e-commerce websites to buy these essentials (preferably at discounted price) & hence demand is migrating from offline to online mode. **if this is durable, then core inflation decline could be enduring.**
- ◆ The 16-bps decline in health (non-institutional) is indicative of the fact that peoples are using services at Government hospitals. This is a triumph for Government that trying hard to provide medical facilities to poor at reasonable cost/free.

CPI INFLATION TRAJECTORY

- ◆ With moderate fuel prices, inflation is currently being driven by food price dynamics. Looking ahead evolving food prices will determine domestic inflation. CPI inflation is expected to remain slightly above 5.0% in the remaining one months of this fiscal leading . Inflation is then expected to decline till Jul'24 but increase thereafter to reach a peak of 5.4% in Sep'24, followed by a deceleration. For the whole FY25, CPI inflation is likely to average to 4.6%.
- ◆ **Interestingly, the correlation between TOP (Tomato, Onion and Potato) as reflected in CPI inflation and Retail TOP prices is at 0.91. However, in recent months, vegetable prices in CPI is being driven mostly by prices of other vegetables in the CPI basket apart from TOP. We thus urge the Department of Consumer Affairs to publish a detailed list of vegetable prices other than only TOP. This will make it easier to fathom the direction of vegetable price impact on CPI.**



Source: SBI Research

All-India, Rural and Urban core Inflation (%)												
Item	Combined				Rural				Urban			
	Weight(%)	Apr-22	Feb-24	Change in bps	Weight(%)	Apr-22	Feb-24	Change in bps	Weight(%)	Apr-22	Feb-24	Change in bps
Overall CPI	100	7.79	5.09	-270	100	8.38	5.34	-304	100	7.09	4.78	-231
Core CPI	47.3	7.09	3.37	-371	37.9	7.86	3.42	-444	58.1	6.28	3.28	-300
Weighted Contribution												
Core CPI	47.3	3.36	1.59	-176	37.9	3.04	1.32	-172	58.1	3.60	1.87	-173
<i>of which,</i>												
Clothing and footwear	6.5	0.64	0.21	-43	7.4	0.80	0.23	-57	5.6	0.45	0.19	-26
Household goods and services	3.8	0.29	0.11	-19	3.8	0.29	0.11	-18	3.9	0.30	0.10	-20
Health	5.9	0.44	0.28	-16	6.8	0.51	0.31	-19	4.8	0.35	0.23	-12
Transport and communication	8.6	0.87	0.15	-73	7.6	0.70	0.15	-55	9.7	1.06	0.14	-92
Recreation and amusement	1.7	0.12	0.04	-8	1.4	0.07	0.04	-4	2.0	0.17	0.05	-12
Personal care and effects	3.9	0.33	0.21	-12	4.3	0.39	0.22	-17	3.5	0.26	0.20	-6

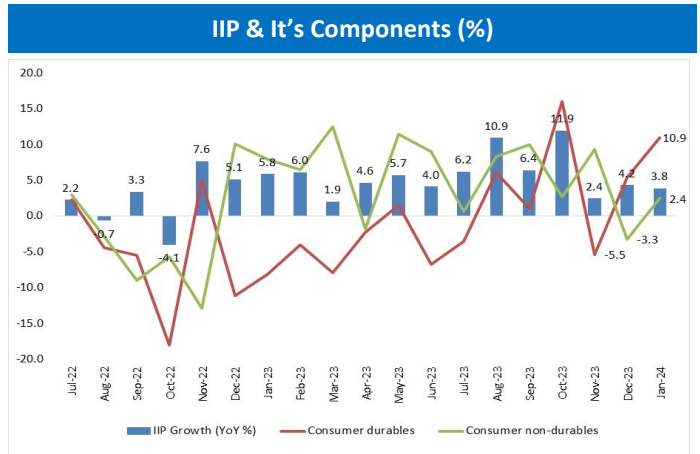
Source: MOSPI, SBI Research, Core of Core CPI excludes transport and communication

IIP GREW BY 3.8% IN JANUARY 2024

- ◆ The IIP grew by 3.8% in Jan'2024 compared to 4.2% (revised) in Dec'23 and 5.8% in Jan'23. Mining grew by 5.9%, Manufacturing grew by 3.2% and Electricity grew by 5.6%.
- ◆ Meanwhile, for April-January 2024, industrial growth stood at 5.9% as against 5.5% in April-January 2023.
- ◆ The Household Consumption Expenditure Survey (HCES) indicate that India is becoming more aspirational as indicated by the increasing share of discretionary consumption (like spending on beverages, intoxicants, entertainment, durable goods, etc.) in rural and urban areas
- ◆ The speed of aspiration is swifter in rural areas as compared to urban areas.

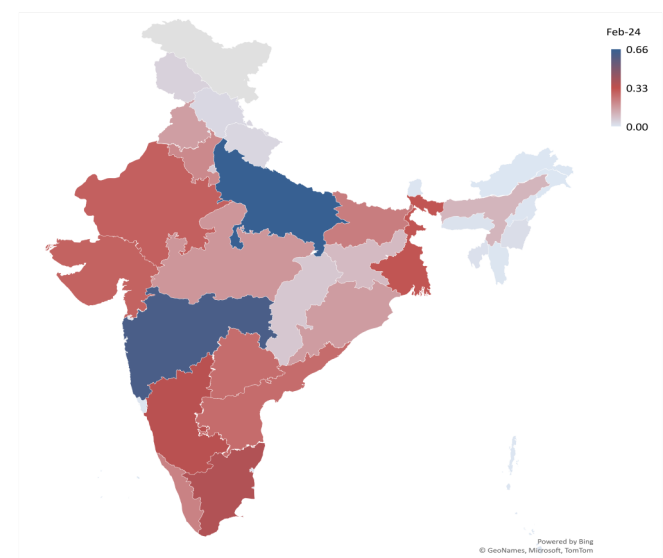
6.5% REPO RATE CONTINUES TO BE THE NORMAL

- ◆ Our ANN model upto Aug 23 with lag 1 data of CPI, Core CPI and Fed rate were constructed.
- ◆ **SCENARIO 1:** If the MPC only considers domestic CPI headline inflation numbers, while taking a call on repo rate, the current rate would be at 6.16%.
- ◆ **SCENARIO 2:** If the MPC had considered only Fed rate hikes, while taking a call on repo rate, the current rate would be at 6.55%.
- ◆ **SCENARIO 3:** If the MPC had considered both domestic CPI headline inflation & Fed rate hikes, while taking a call on repo rate, the current rate would be at 6.53%.
- ◆ **SCENARIO 4:** If the MPC had considered domestic CPI headline inflation, CPI Core inflation & Fed rate hikes, while taking a call on repo rate, the current rate would be at 6.55%.
- ◆ Based on all the scenarios, the current repo rate at 6.5%, looks ideal. We can expect the first rate cut only in Q2FY25.



Source: SBI Research

Spatial Distribution of CPI Inflation



Source: SBI Research

Repo Rate Decomposition					
Optimal Repo Rate based on mutually exclusive scenario					
Month	Repo rate	Scenario 1: If only CPI has been considered for deciding Repo rate	Scenario 2: If only Fed rate has been considered for deciding Repo rate	Scenario 3: If both CPI and Fed rate have been considered for deciding Repo rate	Scenario 4: If CPI, Core CPI and Fed rate have been considered for deciding Repo rate
Oct-23	6.5	6.21	6.55	6.53	6.68
Nov-23	6.5	6.27	6.55	6.53	6.68
Dec-23	6.5	5.93	6.55	6.53	6.61
Jan-24	6.5	5.84	6.55	6.52	6.53
Feb-24	6.5	6.15	6.55	6.53	6.57
Mar-24	6.5	6.16	6.55	6.53	6.55

Source: SBI Research

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Contact Details:

Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in,
gcea.erd@sbi.co.in
Phone:022-22742440
 : kantisoumya